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ACTIVITIES OF THE TRANSNATIONAL CORPORATIONS AND MANAGEMENT DIVISION AND ITS JOINT UNITS

Role of transnational corporations in South Africa

Report of the Secretary-General

SUMMARY

The present report analyses the current economic situation in South Africa and identifies a need for structural readjustments in its economy. It then proceeds with an examination of some economic policy measures that are available to the Government.

Section I presents the current economic setting of the country in the context of the world recession. Unfavourable external and internal constraints are set off against more favourable balance-of-payments, currency, monetary and fiscal developments. A more favourable outlook is also presented for gold, South Africa's main export. Section II examines some economic measures that the Government has initiated or may undertake in the context of the need for structural readjustments of the economy. The measures discussed are the abolition of the dual exchange rate system; the privatization of industry; the restructuring of the economy by focusing on projects aimed at beneficiating South Africa's mineral wealth other than gold; and the fostering of a favourable tax regime. If mobilized, all of those measures would create an environment more conducive to attracting transnational corporations. Section III presents some overall conclusions.

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INTRODUCTION

1. In its resolution 1992/34 of 30 July 1992, the Economic and Social Council requested the Secretary-General, inter alia, to continue preparing studies on the level, form and responsibilities of operation of transnational corporations in South Africa, including their non-equity business arrangements and their involvement in particular sectors of the South African economy. The Council, in the same resolution, also requested the Secretary-General to continue examining possible contributions of transnational corporations to the construction of a united and non-racial democratic South Africa in the economic and social fields, taking into account the special need for development in the areas of human resources, particularly the training of black South African entrepreneurs, employment, housing and health, and to report to the Commission on Transnational Corporations at its nineteenth session, the Council and the General Assembly on the implementation of that resolution.

2. The present report deals with the involvement and possible contributions of transnational corporations to an economy going through a period of readjustment. The Transnational Corporations and Management Division of the Department of Economic and Social Development of the United Nations Secretariat has discussed extensively the role that transnational corporations may play in the training of the black population in the reports (E/C.10/1991/10, and E/C.10/1992/6 and Corr.1) submitted to the Commission in 1992 and 1991 under the item entitled "Transnational corporations in South Africa". Moreover, a report combining excerpts from those two reports was submitted as a background paper under the title "Role of transnational corporations in employment and education of black South Africans" to the Follow-up Conference on International Educational Assistance to Disadvantaged South Africans, organized by the United Nations Educational and Training Programme for Southern Africa (UNETPSA) in cooperation with the Advisory Committee on UNETPSA and held at United Nations Headquarters on 8 and 9 September 1992.

I. THE ECONOMY IN THE CONTEXT OF WORLD RECESSIONARY CONDITIONS

A. External and internal constraints 1/

3. South Africa has an open economy that is highly dependent on international trade. As such, it has been affected both by sanctions imposed by its major trading partners in the mid-1980s and by the world recession of the early 1990s. A protracted global recession can, in fact, have a more damaging effect on South Africa's economy than the sanctions imposed by its trading partners, since South Africa has, through ingenious methods, been somewhat able to partially circumvent sanctions, at least on some of its trade.

4. In addition to external factors, namely, sanctions 2/ and the world recession, some domestic constraints resulted in a further deterioration in

economic conditions in South Africa during the first half of 1992 and in a deepening of the recession there. Those included a major decline in agricultural production caused by a severe drought in the areas of summer rainfall; disappointment with the progress made in the search for a new constitutional dispensation; an escalation in violence, industrial actions and mass demonstrations that adversely affected the performance of the economy; and a further erosion of investors' and consumers' confidence.

5. As a result of the concurrence of these factors, real gross domestic product declined by 0.5 per cent in both 1990 and 1991, and at annualized rates of 2 and 2.5 per cent in the first and the second quarter of 1992, respectively. Gross domestic fixed investment declined persistently through the first half of 1992, from 26.2 million rand in 1989 to 23.6 million rand in 1991, as consumers' and investors' confidence waned. The ratio of total savings to gross domestic product, which had averaged about 24.5 per cent in the 1980s, declined to 19 per cent in 1991 and to 18 per cent in the first six months of 1992. There was a further contraction, of 2.1 per cent, in total employment in the non-agricultural sectors of the formal economy in 1991, which implies that the number of unemployed increased rapidly over that past year. The private sector is currently eliminating jobs at the rate of about 1,000 a day at a time when it needs to create jobs at that very rate just to absorb new graduates entering the labour pool. 3/ Although the official statistics on unemployment are incomplete, 4/ the Government has accepted that actual unemployment is well over 20 and could be as high as 30 per cent. It is the black population, however, that at present is bearing overwhelmingly the main burden. According to the Economist Intelligence Unit, some 40 per cent of the economically active black population is unemployed. Another way of realizing the severity of the unemployment situation is to compare the number of unemployed with those who are employed - 7 million versus 8 million, according to one estimate. 5/

6. According to the scenario study conducted in 1991 by old Mutual/Nedcor, 6/ no country has ever experienced a successful transition to a stable economy in the absence of a sound economic performance before, during and after the transition. In light of South Africa's economic situation it has become clear that there needs to be a major redistribution of income and wealth in the country and that both the current and the future interim Government's policies, as well as foreign investors, have a crucial role to play in this process. Following Nelson Mandela's statement in January 1992 that the country faced a choice of either foreign investment or nationalization but not both, the African National Congress (ANC) softened its stance on nationalization as an economic objective and the policy is being evaluated constantly.

B. Favourable balance-of-payments, currency, monetary and fiscal developments

7. Against the background of these unfavourable economic conditions, one persistently encouraging development in the economy has been the sustained favourable performance of the current account of the balance of payments:

1991 registered as the seventh consecutive year in which total exports of goods and services exceeded total imports, with a current account surplus of 7.4 billion rand amounting to 2.5 per cent of gross domestic product (GDP) (see table 1). However, the surplus was estimated to decline to 4.5 billion rand for 1992 and to 3 billion rand for 1993, as is also shown in table 1.

Table 1. South Africa's balance-of-payments current account

	1990 a/	1991 b/	1992 c/	1993 c/
		(Millions of rand)		
Merchandise exports free on board (f.o.b.)	42 385	45 917	48 700	57 000
Net gold output	18 070	19 649	19 400	20 000
Merchandise imports f.o.b.	-44 100	-48 176	-52 500	-63 000
Trade balance	16 355	17 390	15 500	14 000
Net services and transfers	-10 568	-9 968	-11 000	-11 000
Current account balance	5 787	7 422	4 500	3 000
		Rand per dollar		
Average exchange rate (rand per dollar)	2.59	2.76	2.90	3.09

Source: Economist Intelligence Unit, Country Report: South Africa, No. 2, 1992.

a/ Actual figures.

b/ Estimates.

c/ Forecasts.

8. Another favourable balance-of-payments development has been an increase in the net reserves of the South African Reserve Bank which, amounting to 11.3 billion rand at the end of July 1992, were up sharply from 0.4 billion rand (the figure at the end of June 1989).

9. The favourable balance-of-payments developments have enabled the South African Reserve Bank, through active intervention in the foreign exchange market, to support a relatively stable real exchange rate for the rand, after adjustment for the difference between the South African rate of inflation and that of its major trading partners. From 31 December 1990 to 31 July 1992 the weighted average value of the rand in nominal terms depreciated by

7.9 per cent, but this figure amounted to less than the difference between the rates of production price inflation in South Africa and the comparable rates of inflation of South Africa's major trading partners. The result was a modest appreciation of 1.6 per cent in the real weighted average value of the rand over this period vis-à-vis the currencies of South Africa's major trading partners.

10. Another welcome recent macroeconomic policy development was the stimulus to a depressed economy provided by government finance. During the fiscal year 1991/92, government expenditure increased by 16.1 and revenue by only 7.4 per cent. The deficit before borrowing increased accordingly to 14.3 billion rand, representing 4.7 per cent of GDP. This policy development was countercyclical; however, it should be noted that the danger of a growing deficit before borrowing on debt servicing costs can be onerous, as these costs are now second only to those of education and larger than those of defence. However, the Department of Finance is aware of this danger and the Minister of Finance strongly determined to reduce the ratio of state spending to GDP.

11. Another positive recent macroeconomic policy development has been the stabilization in the growth rates in domestic monetary aggregates which has made a major contribution towards reducing inflationary pressures in the economy. Progress has been made since 1989 towards establishing the conditions that are basic for greater financial stability. The rate of increase in the broadly defined M3 money supply 7/ declined from 27 per cent in December 1988 to 22 per cent in December 1989, with a further decline to 12 per cent in December 1990 and to 10.6 per cent in February 1992. Over the 12 months from June 1991 to June 1992, M3 increased by only 7.5 per cent. Moreover, the corresponding rate of increase in total credit extended by the monetary to the private sector declined from 28 per cent in December 1988 to 20 per cent in December 1989, with a further decline to 16 per cent in December 1990 and to 9.1 per cent in June 1992. The present rates of increase are viewed by the South African Reserve Bank as having the potential to gradually reduce inflationary pressures further.

12. The abatement in inflation has not yet been reflected in the consumer price index (which in fact increased at the rate of 15.3 per cent in 1991 compared with 14.7 per cent in 1989), owing to the many rigidities inherent in the market transmission mechanism. Those rigidities create unavoidable and relatively long time-lags between the application of market-oriented monetary instruments, and the eventual effects they may have on the consumer price index. However, the Reserve Bank is optimistic that inflation will be brought down to a much lower level over the next year or so. In fact the increase in producer prices declined from 15.2 per cent in 1989 to 11.4 per cent in 1991 and by September 1992 the increase in producer and consumer prices was down to 13.5 per cent. 8/

13. A lower inflation rate will also justify lower nominal interest rates. Indeed, the Reserve Bank's bank rate was lowered consistently, from 18 per cent in 1989 to 17 per cent in 1991, with further declines to

16 per cent in March 1992, to 15 per cent in June 1992 and to 14 per cent in November 1992. The Reserve Bank has been progressively reducing its discount rate mainly because it has been satisfied with the progress made towards reducing the economy's underlying inflationary pressures.

C. Gold: a more optimistic long-term outlook

14. According to an estimate provided by the Anglo American Corporation, the world's largest gold producer, if the present price of gold (approximately US$ 340 per ounce) persisted for a year, many more marginal South African mines would be forced to close. 9/ This corporation also estimated that a price of US$ 500 per ounce was needed to keep South Africa's output stable, while a price of US$ 400 per ounce would cause the country's annual production of about 600 tons to drop by 100 tons over the next 10 years. A price of US$ 600 per ounce is needed if South African production is to increase. (South African gold output was down only slightly - by 20 tons, to 601 tons in 1991 - since the recent peak in 1988.) 10/

15. Prospects for an upcoming resurgence in the price of gold seem better in the future than they have been over the last two years. A sudden tightening of the balance between supply of and demand for gold has occurred. In 1991, jewellery fabrication demand rose nearly 4 per cent, to a record 2,111 tons, over that in 1990, while total fabrication demand for electronics, dental use and bullion coins rose 4.2 per cent, to 2,543 tons, over that in 1990. 11/ Of course, these figures would seem insignificant should there be any central bank disinvestment. Central banks have 35,000 tons of the metal in their vaults, and this is equivalent to about 17 years of production. 12/ In the past few years central banks have been net sellers, and they have the potential to limit price increases in the next few years as effectively as producers engaged in forward selling over the past few years. Some of the European central banks, which all together own about 40 per cent of the world's official gold reserves, might seek to reduce their gold holdings before the implementation of legislation for a new European central bank that could require each European Community member to deposit a proportion of its reserves with that institution. The main factors that have kept the price of gold down over the last year or so were the substantial liquidation of gold stocks by the former Union of Soviet Socialist Republics (USSR) (amount: 100 metric tons), Iraq (amount: 50-70 metric tons), the Belgian Central Bank (amount: 202 metric tons) and the Dutch Central Bank (amount: 400 metric tons). 13/ When measured against world mine production of 2,156 tons, these amounts, which the market has been able to absorb, are obviously significant.

16. The incipient recovery in the economy of the United States of America and any ensuing moderate or strong international economic growth should have a beneficial impact on the price of gold through a rising demand for gold jewellery. A rise in the price of metals and other commodities usually follows a rise in industrial production by about six months. In recent history gold has been a harbinger of rising and falling commodity prices. For instance, the United States Commodity Research Bureau's index bottomed in

mid-1986, with the price of gold having reached a low one year earlier. Similarly, in mid-1988 the Commodity Research Bureau's index peaked and again gold had reached a cyclical high in late 1987. Prospects of higher inflation under a scenario of strong world economic growth would involve an upward spiralling of the price of commodities, although rises in the price of gold do not necessarily always depend on high rates of inflation. For instance, from January 1986 to December 1987, the price of gold rose from $320 per ounce to a high of $500 per ounce, while inflation in the United States ran at an annual rate of 2.8 per cent.

D. Recent involvement of transnational corporations

17. According to various sources including data compiled by the United Nations, South Africa has enjoyed a renewal of foreign investments since President F. W. de Klerk embarked on a project of reforms in late 1989. One observer, for instance, identified a total of 51 new investments made in South Africa since late 1989, with the 20 to which an exact size could be ascribed having a cumulative value of just over $700 million. 14/ A heavy concentration of those 51 investments occurred in relatively few sectors. The most important has been the motor sector, accounting for 27.5 per cent of new investments in the last three years. Significant new investments have also taken place in the beverages sector (19.6 per cent), electronics (15.7 per cent), chemicals and oils (11.8 per cent) and engineering (11.8 per cent). All of these sectors where recent investments have been made are highly integrated vertically, knowledge- and communication-intensive, and quality-dependent; such features characterize those sectors connected with the majority of international cross-border investments. The balance of investments were in construction (5.9 per cent), pharmaceuticals (3.9 per cent), paper and packaging (2.0 per cent) and steel and allied industries (2.0 per cent).

18. Another observer, in the most recent survey of the Investor Responsibility Research Centre published in 1992, identified a total of 508 non-American transnational corporations having direct investment or employees in South Africa, compared with the 454 corporations reported in its 1991 survey. 15/ Of those 508, 153 were based in the United Kingdom of Great Britain and Northern Ireland and 142 in Germany. Firms based in the United States numbered 111. According to that observer, 303 non-American transnational corporations had non-equity links (representing a net increase of 132 from the year before), and 256 American transnational corporations had non-equity links (compared with 232 the year before).

19. However, since February 1992, the prevailing atmosphere of political uncertainty has made foreign investors cautious, and little flow of capital has gone into the country. Two cases reported in the press include the acquisition of Jamestone Exploration by International Platinum (Canada) 16/ and the establishment of a subsidiary by Guinness (United Kingdom) to expand its distribution network. 17/ Some other recent investments reported in the press by firms based in Germany include the acquisition by Chemetall (a

subsidiary of Dynamit Nobel Aktiengesellschaft (AG) (a joint-stock company), the chemical subsidiary of Metallgesellschaft (AG) of the entire share capital of the privately owned South African firm Chemical Consultants and Services; the acquisition by Shahlgruber Otto Gruber of Rema Tip Top Industrial, its South African industrial rubber manufacturing licensee; and the 60 per cent stake of the Hoechst in Noristan Holdings. 18/ Two transnational automotive manufacturers based in Germany, namely, Mercedes-Benz and Bayerische Motoren Werke AG (BMW), have been planning capital expenditure programmes of 500 million rand and 300 million rand, respectively. 19/ Compared with European firms, United States firms have been slower in returning to South Africa because of more than 60 State, county and city selective contracting laws that penalize firms awarding contracts in South Africa. Moreover, a few major deals that were on the verge of being announced after June 1992 by United States firms have now been put on hold in view of the high degree of political uncertainty that has been heightened by the recent outbreak of violence; the companies most often mentioned in the press include Apple, Heinz, Pepsi-Cola and Sara Lee. 20/ Obviously, these companies are looking to South Africa's long-term potential and the high degree of profitability of the South African market; in 1991, United States investment amounting to $900 million yielded profits of $126 million. 21/

20. Transnational corporations attempting to get an early foothold in South Africa consider not only its vast potential as a market for consumer goods and health and education equipment but also its potential as an export platform into the region and as a supplier of capital goods and expertise to regional projects. Although only 6-7 per cent of South Africa's total exports are destined for Africa, 20-30 per cent of finished goods are exported to the continent. 22/ The main African export markets are Botswana, Lesotho and Swaziland, which are part of a customs union with South Africa, Zimbabwe, Zambia and Mozambique. Continued growth in the exports of South Africa is partly attributable to the success of the General Export Incentive Scheme (GEIS), introduced in April 1990, which has been offering more generous subsidies as products move up the value scale.

21. Envisioning an increased European transnational corporation presence in South Africa, several South African banks have set up or purchased banks in London. Investec Bank has bought Allied Trust Bank in London for $43 million. Standard Bank has set up a significant subsidiary in London and purchased the offshore interests of the United Kingdom merchant bank Brown Shipley. Most recently, the First National Bank, one of the republic's largest banks has agreed to pay around $83 million for the United Kingdom merchant bank Henry Ansbacher. 23/ These acquisitions mark the beginning of the republic's attempts to re-establish itself in Europe with a view not only to earning hard currency but also to attracting investment into South Africa, as the banks have found it difficult to service their transnational clients satisfactorily without a European presence.

22. Indeed, over the past year there were about 10 large, officially funded trade missions from the United Kingdom to South Africa. To these can be added visits by a number of high-level officials from Germany, including the

Minister of Economic Affairs, the agricultural, economic and transport committees of the Bundestag (lower house of the German Parliament), various deputy ministries and other politicians. In April 1992, a mission led by Derek Keyes (who at the time was South Africa's Minister of Trade and Industry and Economic Coordination) to China, Japan, India and Taiwan Province of China, had as its objective the revival of trade and other financial links with the region of the world represented by those countries. In particular, the delegation was keen to rebuild trade with Japan and to encourage Japanese investment in South Africa, particularly joint ventures. 24/ In November 1992 under a series of advertisements entitled "The Challenge of the New South Africa", various industry leaders were interviewed in the Financial Times in an effort to attract foreign investors.

II. ECONOMIC POLICY MEASURES THAT WOULD ENCOURAGE LONG-TERM INWARD FOREIGN INVESTMENTS BY TRANSNATIONAL CORPORATIONS

23. The review of South Africa's economy in section I above depicts a country urgently in need of foreign capital, especially capital that would be channelled into labour-intensive industries so as to take advantage of South Africa's vast labour supply. The question what policy measures the Government has at its disposal to attract more foreign investments then arises. The present section examines a few such measures.

24. The recent favourable balance-of-payments developments that have allowed the Government to pursue a relatively stable real exchange rate for the rand have now set the economy on an anti-inflationary course. This has also been reflected in the recent interest rate reductions pursued by the Reserve Bank, which would set the economy on a path of future growth situated at a level higher than that pursued over recent years. The Government, therefore, should now be less constrained by the goal of achieving financial stability and the containment of inflation as a policy priority. It would now seem for the near-term future that, once the mass unemployed become enfranchised, unemployment, will be the highest priority. A power-sharing interim Government will be under great pressure to tackle the problem of mass unemployment, which will put an enormous burden on monetary and fiscal policy. Given the magnitude of the numbers of unemployed, the issue arises of what measures are available to the Government in terms of policy instruments that can be mobilized effectively in an effort to create an environment more conducive to attracting foreign investments, particularly those that would alleviate the problem of unemployment.

A. Instituting a single exchange rate system

25. One policy measure available to the Government would be to abolish the dual exchange rate system, namely the financial rand. At present, when a non-resident sells a South African asset, financial rand are created that can then be bought by other non-residents for use in their own South African investments. Therefore, all divestment by non-resident transnational

corporations is automatically met by new investment and the price of the financial rand can and does vary independently of that of the commercial rand. Financial rand invariably trade at a discount vis-à-vis commercial rand but the size of the discount depends on South Africa's relative attraction to other investment destinations. The discount of the financial rand vis-à-vis the commercial rand eased from an average of 53 per cent in 1986 to 13.5 per cent in 1991. It widened briefly to 33 per cent in February 1992 owing to apprehensions about taxation on foreign investments, and to 40 per cent in November 1992 owing to the continued negative political sentiment and the increased pace of investments abroad by South African firms. 25/ In an attempt to curb disinvestments by local companies that had put South Africa's investment currency, the financial rand, under severe pressure at the end of 1992, Derek Keyes, the Minister of Finance, announced on 1 December 1992 that South African companies wishing to invest abroad would have to finance their investments by raising loans overseas rather than by using the financial rand, unless the investment was of immediate benefit to the country. 26/ That such a measure could be regarded as a transitional one within the framework of the Government's broader thinking on the subject of relaxing foreign exchange controls was indicated by its policy statement in March 1992 that it would start intervening in the financial rand market, partly to stabilize the currency, and that this should lead to a gradual narrowing of the discount. Given foreign exchange reserves available to the Reserve Bank sufficient to narrow the discount to minimal levels, the abolition of the financial rand would be hastened, and this was an objective that the Government would aim for in the context of a broader policy of normalizing financial relationships with the rest of the world. A recent statement by the Reserve Bank Governor, constituting another policy pronouncement by the Government along the same lines, indicated that "the exchange rate cannot be allowed to depreciate in isolation, but as part of a broadly based economic and tariff-reform package ... Once tariffs come down, surcharges are dropped and exchange controls are scrapped, the rand will automatically drift to lower levels, based on the state of the economy. We will not try to stop this because our policy is more focused on controlling the money supply than in protecting the rand". 27/

26. The immediate effect of the abolition of the dual exchange rate system would be a lower commercial rand. A lower rand would increase exports by making them more price-competitive abroad. That exporters would receive an immediate export boon is demonstrated by statistics on South Africa's exports in the second half of the 1980s. Despite trade sanctions having been in place between 1984 and 1990, a fall in the value of the rand from about US 90 cents in 1984 to US 36 cents at the end of 1985 (a level which was maintained for most of the subsequent years) induced a rise in the value of merchandise exports amounting to an average annual rate of increase of 22.5 per cent. The undesired effect was of course a higher inflation rate, which reached 20.7 per cent in January 1986. However, that inflationary shock, followed by a rigorous monetary policy applied since October 1989, is in the process of being subdued, and this should allow the authorities more leeway in instituting a phasing out of the dual exchange rate system. It should also be noted that the abolition of the dual exchange rate system would remove

important distortions in the economy, including artificially high levels of liquidity and a level of concentration of control that has contributed to oligopolistic distribution distortions, that have had inflationary repercussions in the longer run. The abolition of the dual exchange rate would also encourage inward investments by transnational corporations. At present, the dual exchange rate system acts as a signal to potential foreign investors that the country represents high risk in the long term.

B. Privatization of industry

27. Another policy measure available to the Government is privatization. Privatization was already thought of by the Government in 1990. However, owing to ANC pressure and union protests at that time, the Government abandoned its privatization plans and focused its efforts on commercialization, which was devised as a halfway measure of running state enterprises along business lines. The policy of commercialization was intended to reduce or eliminate the Government's financial commitment to parastatals. Since then a number of entities have been commercialized including Telkom, the Post Office, TRANSNET (a transport services parent company) and the Armaments Corporation of South Africa (ARMSCOR), which are now reported to have become more financially accountable, efficient and competitive, and less unprofitable, than they were. 28/ The Government also plans to commercialize all of the nine state airports by 1 April 1993, so that the airports will be able to charge market rates for their services and premises; they will also be able to raise loans and retain their earnings. 29/

28. Moreover, the Government has privatized a few entities including the South African Oil, Coal and Gas Corporation (SASOL), the Iron and Steel Corporation (ISCOR) and National Sorghum Breweries. The privatization of National Sorghum Breweries in 1991 proved to be a model for raising capital and redistributing wealth among the shareholders who are mostly workers, and black entrepreneurs, and the company is reported to be more profitable than ever. Despite ANC opposition, the Government seems resolved to go ahead with the full privatization of the Abattoir Corporation (ABACOR). 30/

29. Privatization as a policy measure can create wealth, and result in a higher level of investment, managerial innovation and better pricing of services. Privatization improved domestic welfare in 10 of 12 cases analysed by the World Bank in Chile, Mexico, Malaysia and the United Kingdom. 31/ Productivity went up in 8 of the 12, and did not decline in the other 4. Expanded investment and diversification of production resulted in fast growth in many of the firms: for example, the Chilean telephone company doubled its capacity in the five years after the sale. Consumers were better off as a result of, or unaffected by, the privatizations in 9 cases; they lost slightly in 2 cases, significantly in only 1. Buyers of the firms made money, but the other stakeholders - labour, consumers and government - also gained. Labour as a whole was not made worse off: in 9 of the 12 cases analysed in detail, workers benefited.

30. Other, non-World Bank studies show that privatized companies experience faster growth and greater cost containment. Forty-one firms fully or partially privatized by public offerings in 15 countries (most of them industrialized, but including Chile, Jamaica, Mexico and Singapore) increased returns on sales, assets and equity, improved internal efficiency by better utilization of physical and human resources, improved their capital structure and became less leveraged, increased capital expenditures, and increased their workforce slightly owing to higher investments. 32/

31. The fact that privatization has in some cases been accompanied by lay-offs is, in the context of South Africa's current economic situation, of paramount importance; however, if such a policy measure is undertaken in the context of a broad economic restructuring programme that fosters the advancement of other labour-intensive sectors, a more competitive overall economic environment can be fostered. Such an environment can be a positive factor with respect to attracting investment in the country by transnational corporations, following the resolution of the political situation.

C. Economic restructuring

32. Another policy measure available to the authorities is to restructure the economy so that it relies less on its traditional exports of gold and other minerals, with more emphasis placed on a broader manufacturing basis. However, this option is a long-term one. For the medium-term future South Africa has another option, one of building on the advantages of operating in this country, while utilizing its abundant natural resources, abundant labour and established infrastructure by focusing on projects aimed at beneficiating South Africa's other mineral wealth. Transnational corporations can get involved in establishing such projects. Mining, in particular gold mining, is the most important sector in the economy. While the value of gold as a percentage of merchandise export earnings declined from a traditional 40 to 32 per cent in 1991, the production of other minerals has been on the increase (see table 2).

33. There are indications of renewed interest from the major mining corporations in some beneficiation projects. 33/ It should not be surprising that such an interest comes at the time of a rather protracted slump in the prices of commodities including gold, since South Africa's average production cost of US$ 294 per ounce in 1991 (despite a 14 per cent decrease on the 1990 figure), compared with average world production costs of US$ 259 per ounce, places it among the highest cost producers in the world. 34/ The last boom in the development of projects adding value to South Africa's raw minerals took place in the 1960s and early 1970s when the price of gold was low and profit margins in the industry were slim. It was during this period that many corporations in the metals and minerals sectors (including Alusaf, Highveld Steel and Vanadium, Middelburg Steel, Tubatse and Union Carbide) began such operations.

Table 2. South Africa's main mineral output

	Gross value a/ (millions of rand)		Volume (thousands of tons, unless otherwise indicated)	
	1986	1991	1986	1991
Gold	17 287	19 296	638	598
Diamonds (thousands of carats)	998	b/	10 228	8 446
Iron ore	473	1 149	24 482	28 952
Copper	550	1 053	184	185
Manganese	273	774	3 719	3 191
Lime and limestone	237	478	c/	c/
Asbestos	99	140	139	149
Platinum group metals	c/	2 675	c/	63
Other d/	3 927	5 136	c/	c/
Total	23 844	30 701		

Source: Economist Intelligence Unit, South Africa: Country Profile, 1992-1993, pp. 29-30.

a/ Excluding coal (see energy).

b/ No longer separately published.

c/ Data unavailable.

d/ Comprising mainly platinum group metals (until 1989) and uranium, for which separate data are not published; including diamonds in 1988-1991.

34. At present, the resurgence of interest in beneficiation projects is evident in the initiation of two very large expansion projects - in stainless steel (the Columbus project) and in aluminium (the Alusaf project) - costing a total of about 9 billion rand. Aside from increasing South Africa's capacity in the production and export of the two materials, these projects would also provide the essential foundation for large-scale manufacturing industries involved in the beneficiation of those materials further downstream. This would create a favourable environment for investment in the country by transnational corporations.

35. The 3.5 billion rand Columbus expansion project will increase the output of stainless steel by 395,000 tons per year, resulting in a total annual production of 515,000 tons. The project is a joint venture between Anglo American, Gencor and the Industrial Development Corporation (IDC) which will be equal (one-third equity) partners.

36. At present Alusaf produces about 170,000 tons of aluminium per year (0.9 per cent of world production) and the proposed 6 billion rand expansion will increase production to 636,000 tons per year (3.6 per cent of world production), of which about 500,000 tons will be slated for exports. 35/ After the expansion South Africa will rank fifth in world aluminium production. Annual world demand for aluminium, according to an estimate by Sumitomo (Japan), is expected to outpace supply by 1.23 million tons by 1995. The project is scheduled to generate an annual turnover of around 2 billion rand, and net foreign exchange earnings of about 1.4 billion rand. It would take approximately three years to bring the smelter, which is to be built using technology supplied by Pechiney of France, into production. 36/ Alusuisse holds a 15 per cent share in Alusaf. Although the capital-intensive nature of the project would require the creation of only 1,400 new jobs for the new plant, it is estimated that up to 30,000 new jobs could be created in the economy as a whole because of the project's economic multiplier effects. The project itself will produce primary aluminium but the company envisages expanding upstream into alumina and bauxite and downstream into rolled, extruded and fabricated products. 37/ This will necessarily require offshore investments because there are no bauxite deposits of note in South Africa. The project's objective is to initially manufacture semi-detached houses but there is scope to negotiate the manufacture of aluminium engine blocks or wheels on a very large scale for a number of transnational motor car manufacturers. Alusaf has already obtained favourable long-term contracts with Alcoa, the world's lowest-cost alumina producer, and Billiton, a subsidiary of the Royal Dutch Shell group, for the supply of alumina (900,000 tons a year) required. 38/

37. Expansion projects in the production of titanium is another area where a number of would-be producers see considerable potential for South Africa becoming a far larger supplier and moving downstream into beneficiation. Through its sole existing titanium mine, Richards Bay Minerals, South Africa produces about 23 per cent of the world's titanium feedstocks; however, the country produces a mere 1 per cent of the world's titanium pigments.

38. Following its recent 1.4 billion rand expansion, Richards Bay Minerals is now the world's largest producer of titanium feedstocks by far. Anglo American is reported to have shown an interest in developing, in the north-western cape, a heavy mineral sands projects that would produce 106,000 tons of titania slag output by 1996, with a second furnace (to be put in production by 2002) that would increase output to 212,000 tons and in addition produce 130,000 tons of pig iron. Other by-products of the mine would be 120,000 tons of zircon and 34,000 tons of rutile. The mine would employ 500 workers in 1994 and 760 by 2002.

39. Three other heavy mineral sands projects are being proposed - two by Rho-Ex (one of the two is situated in northern Natal and the company has formed a joint venture with Shell South Africa (SA), which bought a 60 per cent share in the project). The third project is being proposed by Severin Mining (Sermin) and involves sand deposits located in northern Natal, but no other information has been released on this project.

40. Another recent project is the new Vantech vanadium plant which was set up through the acquisition for 17 million rand of the Rand Mines failed Vansa vanadium plant in eastern Transvaal. The plant was started up in May 1992 with a planned output of 3,000 tons of vanadium pentoxide per year. At present the plant is being modified for the purpose of producing ferrosilicon and was due to start production in January 1993. Planned production is 55,000 tons of 75 per cent ferrosilicon per year.

41. Two projects for the production of platinum are also being planned. One is the Johannesburg Chamber of Industries' (JCI) Potgietersrust Platinum (PP Rust), which is scheduled to start mining in mid-1993 at a production rate of 200,000 tons of ore per month. This is scheduled to increase to 300,000 tons per month after nine years. At the initial production capacity, 170,000 ounces of platinum, 165,000 ounces of palladium, 13,000 ounces of gold, 4,500 tons of nickel and 2,500 tons of copper will be produced annually. The other plant is Gold Fields Northam Platinum which at full output will produce 250,000 ounces of platinum annually. The mine will be the first to operate solely on hydropower. A precious metals refinery is to be added to the mine within five years.

D. Regulatory framework 39/

42. The concerns of prospective foreign investors, in addition to focusing on a climate of political stability and macroeconomic balance, usually relate to the regulatory environment, particularly the tax regime as well as the repatriation of dividends.

43. South Africa's regulatory environment is a rather favourable one with respect to attracting foreign investments. The business and industrial community is not overregulated by international standards and regulatory provisions generally apply to both local and foreign-owned companies. Imports are subject both to a quantitative control and to the provisions of a tariff protection system. Export licences are required only for strategic goods, some foodstuffs and items in a few other categories, but exchange control approval is necessary if payment is to be made in any foreign currencies.

44. According to a 1992 report compiled by South Africa's Industrial Development Corporation and released as an official Department of Trade and Industry publication, further liberalization of South Africa's regulatory environment is to be expected. Such liberalization would include cutting tariffs, abolishing import surcharges, lowering corporate taxes, abolishing the General Export Incentive Scheme, eliminating tariffs on goods not made locally, signing of agreements connected with the General Agreement on Tariffs and Trade (GATT) Anti-dumping Code, revamping the Southern African Customs

Union and procuring South Africa's reclassification as a developing country for the purpose of its gaining more favourable trade terms. The combined effect of these measures would be favourable to the attracting of foreign capital. 40/

45. South Africa's financial system is well developed and tightly controlled and there is a well-developed insurance and pension fund industry. Licences for new banking and insurance companies are unlikely to be granted and foreign investors are unlikely to be granted major interest in banking and the insurance businesses. Aside from restrictions on the foreign ownership of banking and insurance there are no other restrictions on foreign ownership.

46. The Government promotes and encourages foreign investment, and there is an emphasis on establishing new industry in labour-surplus areas. The Government prefers foreign entrepreneurs to start new ventures in partnership with South African residents and relaxes the restrictions on local borrowings accordingly. Foreign investors can carry on business by licensing, direct trading by importation, proprietorship, partnerships, and the setting up of branches of overseas companies. The Government prefers the registration of local subsidiaries. The Reserve Bank has a strong preference for foreign-owned investments' being financed in the form of shares.

47. Exchange control permission is required for the inward transfer of equity share capital in financial rand. Foreign investments through other means (as for example the acquisition by a foreign company of a local one by means of an exchange of shares) would require prior approval, which would be granted only in exceptional circumstances. There is no restriction on the repatriation of capital investments in financial rand and profits earned since 1 January 1984 by foreign investors are freely transferable to the investor's country of domicile, but restrictions can be imposed if a remittance would result in increased local borrowing by a foreign-controlled enterprise.

48. Incentives are equally available to domestic and foreign investors. Non-tax incentives are largely available through the Industrial Development Corporation and regional development corporations. Regional incentives are in the form of loans; rent, wage, equipment and utility subsidies; and price preferences. Export incentives include insurance, compensation schemes, and development and transportation concessions.

49. Although tax incentives are generally being phased out, they can be very important in attracting foreign investments. Citing a need to remove any disincentives to companies investing in South Africa, Derek Keyes, Minister of Finance, announced in June 1992 that all interest on foreign investment would currently be exempt from taxes. 41/

50. The importance of a favourable tax regime cannot be overstated. In the case of the above-mentioned Columbus expansion project, the partners in Columbus-Highveld Steel and Vanadium (Hiveld) and Samancor had lobbied the Government for accelerated tax allowances on beneficiation projects, which were finally introduced in 1991 under section 37E of the Income Tax Act. 42/

Through the section 37E allowances, the tax benefits received by a company upon the depreciation of machinery, plant and buildings are speeded up. A company investing in a beneficiation project can deduct those allowances and other pre-production expenses in the year in which they are incurred. Previously, a company could effectively claim such benefits only when it had generated sufficient profits against which the allowances might be offset. That often meant that the company would operate for several years during which time a sizeable tax loss was built up but could not be utilized, while inflation reduced the value of the tax allowances. Now, under section 37E, if the company claiming the deductions does not have enough of a tax base against which to offset the allowances, it can trade the tax loss to another tax-paying company for a cash payment and as a result receive immediate benefit. Tax allowances of such a nature are important for big investment or expansion projects because of the enormous amounts of capital expenditure involved and the long lead-time (several years) elapsing before enough profits are made to permit the accumulated tax losses to be claimed. The institution of more favourable tax incentives of such a nature would encourage the inflow of foreign capital.

III. CONCLUSIONS

51. The analysis presented in the present report depicts a country faced not only with an urgent need for cyclical recovery, but also with the need for some structural readjustments to bring the economy back onto a path of sustainable higher-level growth and provide employment for the masses of unemployed. The low, and at present even negative, economic growth, is aggravating the already serious unemployment situation, increasing poverty and reducing the average standard of living; however, some degree of macroeconomic balance, which is an important factor in attracting foreign investors, has been achieved.

52. The South African Government does not lack for economic policy measures at its disposal. This report discussed a few policy measures that may be utilized by the Government in its search for a solution to the problems facing the country. All measures would encourage the inflow of foreign investments by transnational corporations. A particular measure can be mobilized independently or in combination with any other measure, or the Government may embark on a course that mobilizes all such measures. The measures vary in terms of their immediate or long-run impact. There are indications of some initiatives taken with regard to most of those measures.

Notes

1/ Unless otherwise indicated, data were drawn from South African Reserve Bank, Quarterly Bulletin, various issues.

Notes (continued)

2/ In previous reports to the Commission on Transnational Corporations, the Transnational Corporations and Management Division of the Department of Economic and Social Development of the United Nations Secretariat has dealt extensively with the issue of the impact of sanctions on the South African economy.

3/ "South Africa violence wounds economy", The Wall Street Journal, 30 September 1992, p. A.10.

4/ The unknown factor is how many full- and part-time jobs there are in the informal sector and how many unrecorded jobs in the formal sector.

5/ Presentation by Bob Tucker to the Follow-up Conference on International Educational Assistance to Disadvantaged South Africans, held at United Nations Headquarters, New York, 8 and 9 September 1992.

6/ Ibid.

7/ M3 comprises coins and bank notes, cheques and transmission deposits, other demand deposits, other short-term and medium-term deposits, and long-term deposits.

8/ "South African interest rates cut", Financial Times, 18 November 1992.

9/ "Gold group warns low price may force closures", Financial Times, August 1992.

10/ "London bullion market", Financial Times survey, Financial Times, 22 June 1992.

11/ Financial Mail, 22 May 1992.

12/ "London bullion market" ....

13/ "Commodities corner", Barron's, 20 July 1992; and "400 tonnes of gold reserves sold by Dutch Central Bank", Financial Times, 13 January 1993.

14/ Centre for the Study of the South African Economy and International Finance, London School of Economics, Summary of findings of a study undertaken by Jonathan Garner (facsimile transmission).

15/ Investor Responsibility Research Centre, International Business in South Africa 1992, Washington, D.C.

16/ "Canadian company acquires South African platinum prospect", Financial Times, 22 April 1992.

Notes (continued)

17/ "Guinness expands in South Africa", Financial Times, 14 May 1992.

18/ "The Germans are coming", Financial Mail, 23 October 1992.

19/ Financial Times survey, South Africa, Financial Times, 5 June 1992.

20/ Ibid.

21/ Ibid.

22/ "Little sign of a sanctions dividend", Financial Times, 14 July 1992.

23/ Centre for the study of the South African Economy and International Finance, London School of Economics, Summary of findings of a study undertaken by Jonathan Garner.

24/ "Pretoria seeks to revive trade with Asia", Financial Times, 24 April 1992.

25/ "South African investment up - but so are the outflows", Financial Times, 26 November 1992.

26/ "Pretoria acts on exchange control curbs", Financial Times, 1 December 1992.

27/ "A blueprint with a difference", Financial Mail, 16 October 1992.

28/ "Back on the path to privatization", Financial Mail, 28 August 1992, p. 75.

29/ Financial Mail, 9 October 1992.

30/ Financial Mail, 28 August 1992, p. 75. Some flexibility in the opposition of ANC was shown in a draft economic policy document released in April 1992, which mentioned for the first time the possibility of reducing the role of the public sector through privatization. See "ANC sets moderate tone", Financial Times, 29 April 1992.

31/ World Bank, Privatization: The Lessons of Experience, Country Economics Department, April 1992.

32/ Ibid.

33/ The names of projects listed were drawn from Financial Mail survey: MINING, Financial Mail, 14 August 1992.

34/ Financial Mail, 22 May 1992, p. 104.

Notes (continued)

35/ "Go-ahead expected for South African aluminium project", Financial Times, 12 November 1992.

36/ "South African smelter decision delayed", Financial Times, 21 August 1992.

37/ "Alusaf swims against the tide", Financial Times, 13 November 1992.

38/ Ibid.

39/ A part of the analysis presented draws on Price Waterhouse information guide, Doing Business in South Africa, 1990.

40/ "A blueprint for industrial policy", Financial Mail, 16 October 1992.

41/ "Tax exemption in South Africa", The Wall Street Journal, 5 June 1992.

42/ The analysis draws on Financial Mail survey: MINING, Financial Mail, 14 August 1992, p. 4.